

(c) Identify and explain **one** cost to the UK of economic growth.

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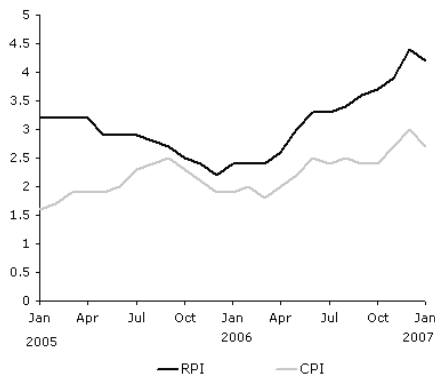
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The rise in economic growth was not good news for everyone. Inflation rose to 3.1% in April 2007, way above the government's target of 2.0%. For businesses the increase in inflation creates uncertainty. How do they plan ahead if prices are rising? Do they increase their prices as well? What about firms trying to sell abroad? They might now be less competitive. Some firms are also likely to face increased demands for higher wages as employees try to keep up with inflation.

Annual Inflation Rate (%) in the UK

Source: ONS, Crown Copyright <http://www.statistics.gov.uk/cci/nugget.asp?id=19>

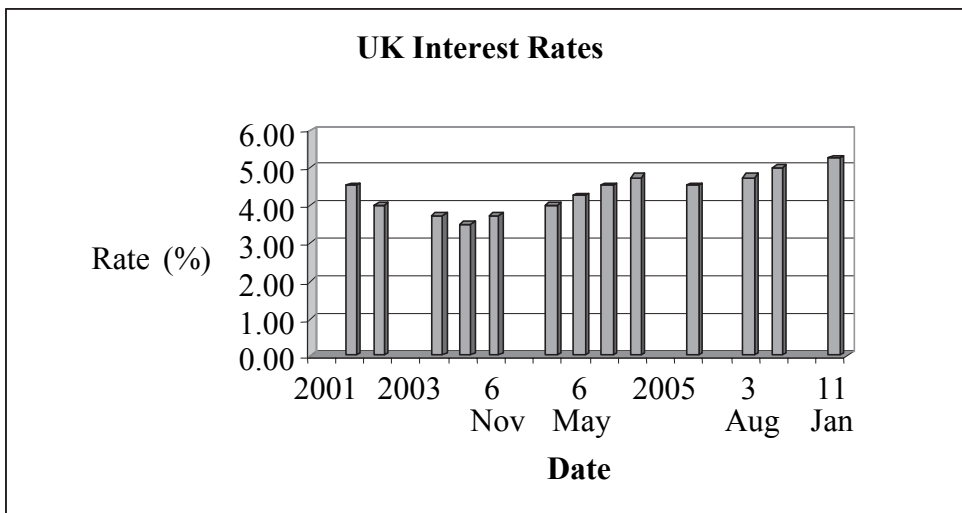
(d) Define the term '*inflation*'.

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Source of data: HM Treasury.

The Bank of England uses interest rates to influence the level of inflation. They increase interest rates when they want to bring inflation down. When the Bank of England increase interest rates, other banks increase their rates as well. This makes the cost of borrowing money for both businesses and individuals more expensive. Businesses might have to cut back on buying new equipment or machinery whilst individuals might think twice before taking out loans for a new car, a holiday or for new furniture or an extension to their house.

(g) Using an example, explain what you understand by the term the '*interest rate*'.

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(h) Explain how an increase in interest rates might help to reduce the rate of inflation.

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The rise in interest rates affects different people and businesses in different ways.



“I have a large mortgage and every time interest rates rise my monthly mortgage payments increase. Every ¼% rise adds about £30 to my monthly payments. I have to think more carefully about what I am going to spend my money on. I may have to think about cutting back on some things that I used to do regularly like going to the cinema or eating out.”

<http://www.sxc.hu/photo/742936>

“I was thinking of buying a new car but the increase in interest rates has made me think twice. I have read in newspapers that this might not be the last rise in interest rates. I do not have a great deal of savings although my mother, who is now retired, does have some savings in a building society that she built up when she was working so she is pleased that interest rates are rising. At times like this I wish I had more savings too.”



<http://www.sxc.hu/photo/5281>



“I have had to borrow money to buy the premises and the equipment for my restaurant. Things have been going well and people have been visiting the restaurant regularly. Things might change now. The rise in interest rates might affect me in two different ways!”

<http://www.sxc.hu/photo/568287>



(i) Read the passages opposite carefully. Using your knowledge of business and economics, explain the points of view of the following people on a rise in interest rates.

(i) Householders with a mortgage.

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(ii) People with savings.

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(iii) A restaurant owner.

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Since 1997, the responsibility for controlling inflation has been given to the Bank of England. It monitors inflation and uses interest rates as the main way of controlling inflation. Since 1997, there has not been as large a swing in the business cycle as happened in the past. Inflation, economic growth and unemployment have all been more stable. For many businesses, these have been the ideal conditions in which to plan ahead and grow. However, they will still have to have plans in place to cope in case there is a future slowdown in the economy.

- (j) Assess the effectiveness of cutting costs as a way for a business to cope with a downturn in the business cycle.

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Q1

(Total 50 marks)

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If you answer this question put a cross in this box ☒.

2. Big or small?

Michael Ashwin runs a private limited company called Hill Farm Furniture. Michael employs 7 people and shares the ownership of the business with his ex-wife, Carolyn. Carolyn does most of the accounts and also the marketing. Michael does the design and planning work. Their staff all have their own jobs to do to help make the business a success.

(a) Using an example, explain what you understand by the term '*specialisation*'?

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(b) Identify and explain **one** benefit to Michael of specialisation for his business.

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(c) Identify and explain **one** cost to Michael of specialisation.

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Hill Farm Furniture has based its growing reputation on quality. It is something that Michael has to remind his staff of on a regular basis. When he first started he only had two people working for him and the business was a very close team. As the business has grown, more workers have been employed. Finding staff with the right skills is not easy. In addition, Michael has to make sure that he keeps them all motivated. As the business has

grown, communication becomes even more important.

Image source: www.hillfarmfurniture.co.uk

(d) Identify **two** methods of motivation that a small business like Hill Farm Furniture might use.

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(e) Which of the two factors you have identified in question 2(d) above is most likely to help improve productivity and why?

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(f) Describe **two** methods that a small business like Hill Farm Furniture might use to communicate with its staff.

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(g) What sort of leadership style do you think would be the most appropriate for Michael to use in a business like Hill Farm Furniture? Explain your answer.

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Michael likes being part of a small business. He knows all of his staff well and each person knows what their job is and works as a team to get the job done. Companies like MFI, Magnet and B&Q, who also supply kitchen furniture, are much bigger. B&Q, for example, employs over 30,000 people. Michael knows that these companies have some advantages in being so big but he also thinks that they have some disadvantages which he does not have.

(h) Define the term '*diseconomies of scale*'.

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Big Business:

At the opposite end of the business scale to Hill Farm Furniture is a business like Mittal. Mittal is the world's largest steel firm and a multi-national business. In August 2005, it signed a deal with the government of Liberia in Africa.

The deal allowed Mittal access to about 1 billion metric tonnes of rich iron ore reserves in Western Liberia. Mittal Steel expected to invest \$900 million during the lifetime of the project. The investment would cover development of the mines, related railway and port infrastructure and provide community development projects. The deal would benefit Mittal's shareholders according to senior managers at the company.

(Source: adapted from www.mittalsteel.com)
<http://www.mittalsteel.com/NR/rdonlyres/4487DE25-EED7-4386-BAD4-ED2A6D1EE58B/591/2005AugLiberia.pdf>

A non-governmental organisation called Global Witness criticised the deal as not being in Liberia's interests. Some people in Liberia believed the deal was more in Mittal's interests than Liberia's. They thought that only around 2000 jobs would be created. Global Witness said the deal would have affected Liberia's control of the railways and its key port. It would also limit Liberia's capacity to regulate human rights, environment and taxation issues.

A new government was elected in January 2006 and re-negotiated the deal with Mittal. Mittal said the new agreement would involve investment now exceeding \$1bn and should generate 3 500 jobs directly and 15 000–20 000 jobs indirectly in Liberia.

Source: adapted from http://www.businessin africa.net/news/west_africa/541932.htm



(i) Read the passage opposite carefully. Using your knowledge of business and economics, explain the points of view of the following on multi-national businesses like Mittal.

(i) The new government of Liberia.

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(ii) Workers in Liberia.

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(iii) A Mittal shareholder.

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Intel, the US computer chip manufacturer, chose to set up a factory in the Central American country of Costa Rica. Since Intel opened the factory outside the capital, San Jose, in March 1998, Costa Rica's economy has been transformed.

The economy in Costa Rica grew by almost 8% in 1999 and there has been a big improvement in the country's export performance. Some Costa Ricans are worried. The central bank president, Eduardo do Lizano said, "Fifty years ago we depended on coffee and bananas; today we depend on Intel". The actual effect on the country's wealth will be reduced by the fact that some of the profits from computer chip manufacture will leave Costa Rica and go to the United States where Intel has its headquarters.

The government wants to keep growth going by seeking more foreign investment. Manufacturers who invest in Costa Rica can get tax benefits. Other Central American countries offer more generous incentives, but Costa Rica has other advantages, rare in the region. These include a sound legal system and a well-educated workforce. Such factors led Intel to choose Costa Rica for its only factory in Latin America.

Source: adapted from *The Economist* (US) 354.8152 (2000): p36. From Biz/ed Custom Journals.

(j) Assess the importance of a multi-national business to a country like Costa Rica.

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Q2

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If you answer this question put a cross in this box .

3. Congestion and Externalities

The number of cars on Britain's roads is increasing. The market for new cars has been especially strong. In the UK in March 2007, new car sales rose by 3.1% according to figures from Just-auto. As sales of new cars have risen, it is having an effect on the prices of second hand cars.

(a) Using an example, explain what you understand by the term '*market*'.

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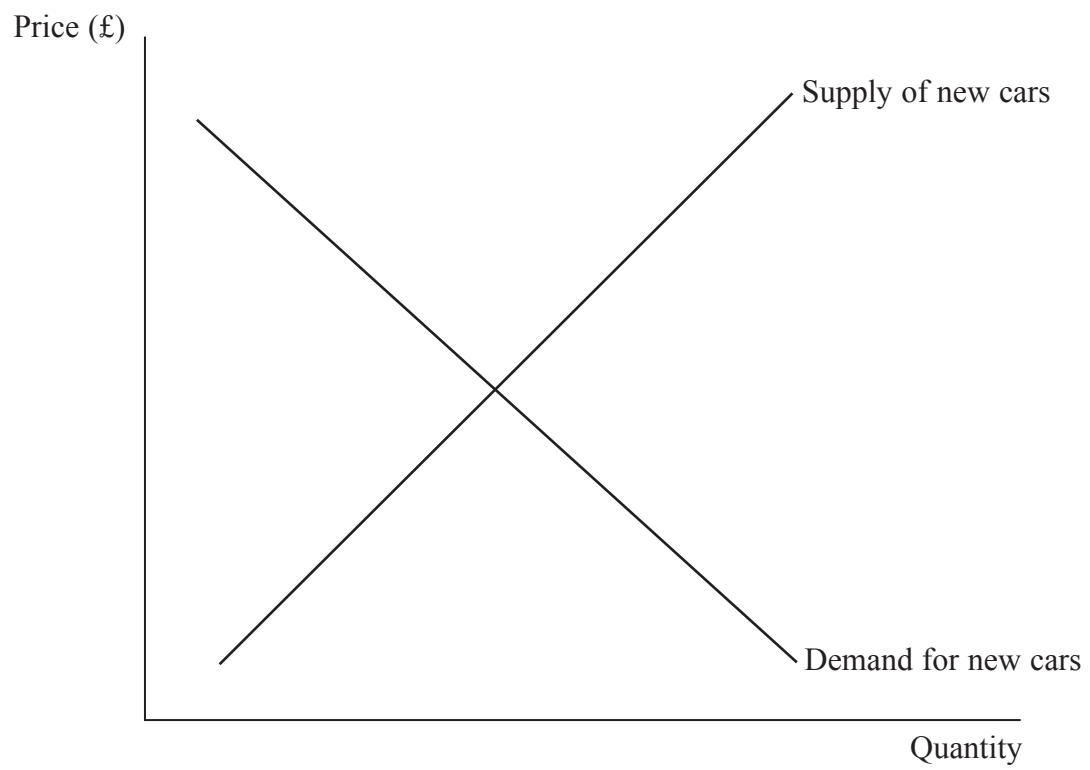
(b) Define the term '*market clearing price*'.

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The diagram below represents the market for new cars.



(c) Use the diagram to help you explain what would happen to the price and the quantity bought and sold if there was an increase in demand for new cars.

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Phil Goodwin, Professor of Transport Policy at University College London, has commented that more people are driving cars but the increase in the amount of road space available is not rising as fast. “This will continue to be the case unless steps are taken to reduce traffic. Building new roads is not an option. The cost of congestion to society is an annual cost of £20 billion. This would rise to £30 billion by 2010.”

Source: adapted from <http://eprints.ucl.ac.uk/archive/00001259/>

(d) Using an example, explain the meaning of the term ‘*externalities*’.

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(e) Explain **one** possible cost to a business of the rise in the number of vehicles on the roads.

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In 2006, the government announced that it would be setting up some tests to see whether road pricing might work. The plans allow cities like Manchester and Birmingham to bring in a system to make drivers pay to use the roads. It was estimated that drivers might pay as much as £1.30 per mile if they chose to travel at peak times of the day. The aim of the scheme is to try and reduce the externalities that arise from the increase in the number of cars on Britain's roads.

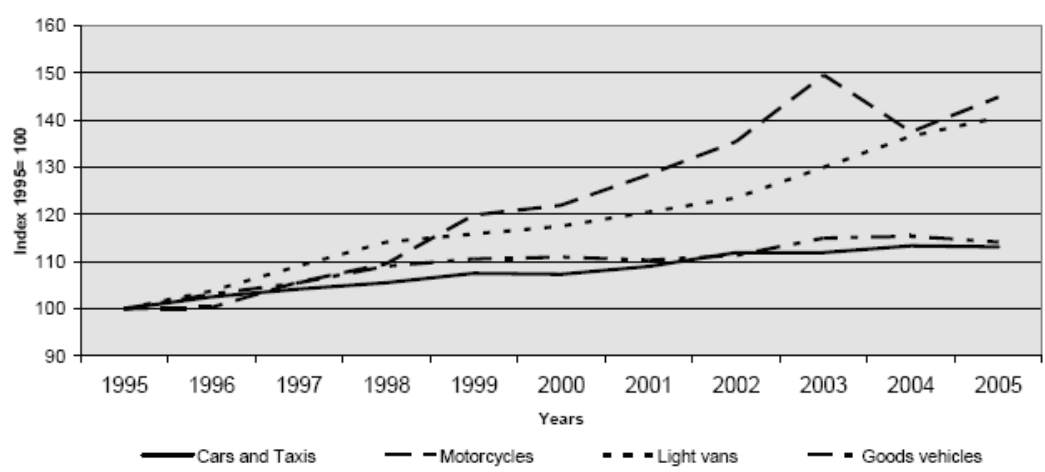
(f) Explain **one** possible benefit to a business of a road pricing scheme.

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Road traffic by vehicle type: 1995 - 2005



There has been a rise in the number of vehicles using the roads over the last 12 years. There is no sign that this rise will slow down in the future.

Source: http://www.dft.gov.uk/pgr/statistics/datatablespublications/roadtraffic/traffic/rtstatistics/coll_roadtrafficstatistics2005in/roadtrafficstatistics2005pdfdoc



“The idea of tracking every vehicle at all times is sinister and wrong. Road pricing is already here with the high level of taxation on fuel. The more you travel – the more tax you pay.

Road pricing will be unfair on those who live apart from families and poorer people who will not be able to afford the high monthly costs. Forget about road pricing and concentrate on improving our roads to reduce congestion.”

Peter Roberts – who led a petition to the government in 2007 to scrap the plans for road pricing. The petition gathered over 1.8 million signatures.

Source: adapted from <http://petitions.pm.gov.uk/traveltax/#detail>

The pressure group, Friends of the Earth has estimated that traffic congestion in London costs the average London household £675 per year. That is over £280 per Londoner per year. All in all, traffic congestion costs the capital almost £2 billion annually.

Roger Higman, Senior Transport Campaigner at Friends of the Earth said:

“Congestion is hitting every Londoner where it hurts – in their wallet.” Friends of the Earth want the government to find ways of reducing the number of vehicles on the road and support road pricing schemes.

Source: adapted from http://www.foe.co.uk/resource/press_releases/19970916141219.html

“Getting around Manchester in a car in the morning is not easy. I **have** to use my car as I am a salesperson but getting to see my clients in the early part of the day is really difficult. I have to leave extra early and even then I am often late for appointments because of the traffic. It only takes one accident to cause a major hold up. Sitting in the car not doing anything is really unproductive and being late can upset my clients although most are very understanding. Some of the clients I visit are not so happy about the prospect of road pricing as it will cost them more to get to work in the city centre in the morning. They also think that less traffic will mean less business for them. Something, though, has got to be done to reduce the traffic on the roads.”



(i) Read the passages opposite carefully. Explain the views of the following on the plans to introduce road pricing as a means of reducing congestion.

(i) Car user.

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(ii) Member of Friends of the Earth.

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(iii) Business person in Manchester.

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